



State Investment Commission

Monthly Meeting Minutes

Wednesday, October 10, 2012

9:00 a.m.

Room 135, State House

The Interim Meeting of the State Investment Commission (SIC) was called to order at 9:06 a.m., Wednesday, October 10, 2012 in Room 135, State House.

I. Roll Call of Members

The following members were present: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo.

Also in attendance: Mr. Allan Emkin and Mr. John Burns, of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; Ms. Sally Dowling, of Adler Pollock Legal Counsel to the Commission; Kenneth Goodreau, chief investment officer and members of the Governor's, Treasurer's and Auditor General's staff.

Treasurer Raimondo called the meeting to order at 9:06 a.m.

II. General Consultant Risk Management Presentation

Treasurer Raimondo thanked everyone for making the effort to come to an interim meeting. The Treasurer explained how PCA came to her and suggested the committee take some time to think about the possibility of a negative market correction, with the focus on the US equity market. The Treasurer explained she did not want to make any decisions without full input from the board.

Treasurer Raimondo then introduced Mr. Emkin to discuss the concepts of risk management and possible methods on which to mitigate risk.

Mr. Emkin explained aspects of the current climate are unprecedented and explained as consultants, PCA does not take this unique situation lightly. He said the board has already systematically addressed a variety of risks, but there is still a significant exposure to growth and equity risk.

Mr. Emkin explained the risks of the general market environment and pointed out the more unfunded a plan is the more disastrous a big negative return could be, because you won't have the ability to recuperate losses. It would be prudent to avoid this situation if possible.

Ms. McNamara asked what has changed in the last few months to warrant this. Mr. Emkin cited a confluence of the recent run-up of the equity markets, general market risk and further that the pricing of these risk-mitigating methods is currently low, because perceived volatility is also low.

Mr. Costello mentioned we have already taken certain measures to mitigate risk and the board would have to strategically time the policy change which is extremely difficult.

Mr. Emkin reiterated the difference between a relative return and absolute return investor. He explained, in his estimation, this board has made a conscious decision to be more concerned about preservation of principal.

Mr. Goodreau explained managing a lot of risk in the markets is out of the board's control, but it is important the board defines what level of risk is prudent.

Treasurer Raimondo elaborated; we are managing someone's pension dollars, not an endowment. The portfolio has still not made up from the loss in 2008 and as the chair of the committee, she is more concerned about not losing people's retirement money than capitalizing on the upside.

Mr. Costello said we should price it out and then make a decision. His main concern is hitting our 7.5% number over a five to ten year timeframe. The Treasurer agreed.

Mr. Reilly asked how broad this protection will go and how does the board make sure it's in the right area. Mr. Emkin said there are a variety of risks, but there is no question the largest single risk in the portfolio is growth risk which is directly related to equity, U.S. equity in particular. He explained the best situation of all is if you don't have to use the insurance policy. Mr. Goodreau mentioned all of our equity is in a passive mandate at very little cost. Only a few years ago, these were active mandates where we paid for active protection against the downside. He explained, though it has a cost, a hedge would be a more effective way to protect against downside than active managers.

Mr. Costello applauded PCA and the Treasurer for having this conversation, but he was concerned about implicitly timing the market. He said the portfolio might have a hard time hitting the assumed rate of return year-over-year if we don't have years where we are up 10-15%, because there will be years where the portfolio is down or only up 2-3%. He believes at some point you need to take risk to hit the return. The Treasurer agreed but pointed out the portfolio might have a difficult time hitting its target rate of return if we have a year like we had in 2008.

Mr. Emkin and Mr. Burns explained risk mitigating options to the board in detail, including simple puts and calls, collars, put-spreads and a put-spread collars.

Mr. Fay sought to define what levels of risk and option pricing the board is willing to tolerate.

Mr. Giudici asked if this was typical for a defined benefit plan to use these types of vehicles and Mr. Emkin answered that it is mainstream.

Ms. Booth Gallogly asked if there are any other ways to mitigate risk and Mr. Emkin said, not without structurally changing policy.

Mr. Goodreau referenced a policy in place which says the board is allowed to take advantage of opportunistic events as long as the action is risk mitigating and not return chasing.

Treasurer Raimondo recommended PCA bring a proposal on what the board should consider with guidelines it should be inexpensive, palatable and not give up too much upside.

III. Adjournment

There being no other business to come before the Board, on a motion by Mr. Costello and seconded by Ms. Reback the meeting adjourned at 10:15 a.m.

Respectfully submitted,

Gina M. Raimondo
General Treasurer